

THE OFFER IN COMPROMISE PROGRAM: AN EXAMPLE OF INEFFECTIVE TAX ADMINISTRATION

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“The Secretary may compromise any civil or criminal case arising under the internal revenue laws ...” (IRC 7122) The Secretary of the Treasury has been authorized to compromise tax liabilities in section 102 of the Act of July 20, 1868. There do not appear to be any limits on the Secretary’s authority to compromise. No court cases have ever included language suggesting the Secretary has exceeded his authority to compromise.

Congress expressed its intent regarding the OIC program in the legislative history of the IRS Restructuring and Reform Act of 1998 as expressed in the following:

“The Committee believes that the ability to compromise tax liability and to make payments of tax liability by installment enhances taxpayer compliance. In addition, the Committee believes that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the Committee believes that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpayers about the availability of such agreements.”

“It is anticipated that the IRS will adopt a liberal acceptance policy for offers-in-compromise to provide an incentive for taxpayers to continue to file tax returns and continue to pay their taxes.”

“... the conferees anticipate that IRS will take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer’s income tax liability would promote effective tax administration.”

The IRS Policy Statement P-5-100, approved January 30, 1992 states:

“The Service will accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential. An offer in compromise is a legitimate alternative to declaring a case currently not collectible or to a protracted installment agreement. The goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the Government.

“In cases where an offer in compromise appears to be a viable solution to a tax delinquency, the Service employee assigned the case will discuss the compromise alternative with the taxpayer and, when necessary, assist in preparing the required forms. The taxpayer will be responsible for initiating the first specific proposal for compromise.

“The success of the compromise program will be assured only if taxpayers make adequate compromise proposals consistent with their ability to pay and the Service makes prompt and reasonable decisions. Taxpayers are expected to provide reasonable documentation to verify their ability to pay. The ultimate goal is a compromise which is in the best interest of both the taxpayer and the Service. Acceptance of an adequate offer will also result in creating for the taxpayer an expectation of and a fresh start toward compliance with all future filing and payment requirements.”

The above policy is still in effect. However, the administration of the law and policy with respect to compromise is in shambles. Furthermore, the manner in which the IRS is handling the program in its design and non-administration is violating the intent of Congress and is, therefore, an abuse of discretion; i.e., abuse through under-use..

In an April, 2001, Wall Street Journal , it was reported that:

“IRS Commissioner Charles Rossotti says major headaches persist with the agency’s program for

compromising with people who can't pay all their tax debts. The backlog of unresolved cases is 'too high,' he says, and it still takes IRS workers too long to reach decisions. 'I can't say any of us are satisfied' with how the program is working.

"The General Accounting Office, a congressional investigative agency, confirms that IRS data show a rapidly rising workload for the troubled offer-in-compromise program. The inventory of unresolved 'workable offers,' those meeting IRS criteria to process them, soared from 32,300 in 1997 to about 87,500 in 2000, says Michael Brostek, GAO's director for tax issues. Mr. Rossotti vows 'very aggressive' action to improve the program."

In a January, 2002, Wall Street Journal, it was reported that:

"... critics have complained that the IRS takes much too long to decide on taxpayer offers. Among those critics is Nina E. Olson, the IRS' national taxpayer advocate. ...

"An IRS spokeswoman says, 'the average backlog for the average case is 10 months.' But more complex cases take much longer. Meanwhile, the number of applications still is soaring. As of August (2001), the backlog stood at about 94,000, up from 62,551 nearly two years earlier, the spokeswoman says. The IRS is trying to respond by adopting an 'inventory-reduction program' that includes special employee training. But the backlog is so big and growing so rapidly that it will take years to make significant progress, Ms. Olson says."

Nina Olson told me that the above quote was the result from an hour interview with Tom Herman of the WSJ. Nevertheless, it does show a degree of consistency with other IRS comments about the program.

We have been trying to constructively influence the IRS since Deputy Commissioner, Bob Wenzel, wrote his famous OIC memo back in April, 1992. Sadly, our efforts have been squandered. It was only through our work with the Commission to Restructure the IRS and then with Congress that we were able to gain support for a change in the program. Unfortunately the IRS still has not heeded the request of Congress to improve the program and the administration thereof. While misguided attempts are being made to speed up processing, there is no evidence that the program itself is being improved according to the expressed wishes of Congress.

The manner in which the IRS is administering and interpreting the OIC program is greatly flawed for the following reasons:

1. It is a great disservice to trained enforcement personnel to ask them to administer and operate a program that goes against their mission.
2. Negative attitudes against the OIC program is manifested by IRS employees in a wide variety of ways:
 - a. Unwillingness to look at a taxpayer's entire financial situation;
 - b. Unwillingness to negotiate potential changes to the proposed compromise;
 - c. Unwillingness to consider individual facts and circumstances when applying IRS standards;
 - d. Unwillingness to consider special circumstances with respect to unavailable equity in assets;
 - e. Unwillingness to accept the spirit of IRS Policy Statement P-5-100;
 - f. Overly rigid attitudes toward credit card debt, unsecured debt, retirement accounts, education expense, contributions, and so forth;
 - g. Incomplete evaluation and investigation of all facts and circumstances;
 - h. Repeated attempts by Revenue Officers to examine and audit tax returns;

- i. Insistence on averaging incomes over prior years as a measure of future income, even though the taxpayers may be unemployed or their businesses are nonexistent;
- j. Unnecessary and onerous additional information requests;
- k. Inordinately long delays (some reportedly up to three years or more); and,
- l. Complete and total disregard for Congressional intent as expressed in the Committee Reports of the IRS Restructuring Act of 1998.

The aforementioned problems are important because they demonstrate the IRS's inflexibility and inability to effectively and equitably administer the OIC program. The IRS has made it almost impossible to resolve taxpayers' debt problems in an equitable and timely manner. After ten years of trying to work offers, it is clear to practitioners that the distaste for the OIC program by the Internal Revenue Service has become and remains institutionalized.

NSA recommends the following fixes:

- 1. Revenue Officers and other IRS employees from the Compliance Division, who are charged with the collection of delinquent taxes should not be involved in, or make, OIC recommendations. This rule is axiomatic.
- 2. OIC guidelines should include provisions for compromises that are based on actual and financial hardship in light of the equitable and common sense concept of effective tax administration. The guidelines should clarify that compromise is quite simply the right thing to do in these situations. Furthermore, new OIC guidelines should be developed by IRS staff who are not involved in the Compliance function.
- 3. The IRS should be made to report on an annual basis the amount of tax-delinquent accounts receivable that are resolved through the use of the OIC program.
- 4. Chief Counsel's Office should not be involved in the OIC program.

In other words, reassign the Offer in Compromise program to a group outside the Compliance area and allow the new functional personnel the opportunity to redesign the process and the manner in which a settlement process is to be administered. After 123 years of benign neglect, and ten solid years of poor management, it is time for the IRS to take another approach. Settlement-oriented IRS professionals need to be involved in a new OIC program; not enforcement personnel. After all, we are dealing with an education and revenue opportunity and not a compliance hammer. The money that is submitted to the Treasury to fund offers generally comes from family and friends and usually do not come from the debtors.

Now, let's sweeten the pot, so to speak. The IRS reported that it has a backlog of about 94,000 cases with about 10,000 new cases coming in monthly. Settling these cases could generate billions of dollars in tax revenues if the program is reassigned and redesigned. According to the IRS, very little is collected from most past due accounts exceeding a year or more; therefore, the IRS is probably forfeiting billions of dollars in potential revenues because most of the past due accounts will fall out of statute. At that point, the collection potential is zero.

Sadly, there are hundreds of thousands of people in pain who could be helped back into a state of compliance by a properly designed and effectively administered OIC program. Until NSA's recommendations are adopted in full, these unfortunate people will continue to suffer in noncompliance unnecessarily while feeling at odds with their government.